COMPANY RESEARCH AND ANALYSIS REPORT

# DYNAM JAPAN HOLDINGS

## 06889

Hong Kong Stock Exchange

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# Summary

## Plans to secure operating profit in FY3/22 through sales initiatives according to customer profile and reforms of hall operations

DYNAM JAPAN HOLDINGS Co., Ltd. <HK06889> is one of Japan's top operators of pachinko halls with the largest number of halls operated. Its strength and characteristics lie in low-cost operations based on the chain store theory. In addition, the Company is a pioneer as the first in its industry to be listed on a stock market, aided by recognition of its high-quality management with implementation of a customer-first approach, information disclosure, compliance management, and other measures.

### 1. In FY3/22 interim results, posted an increase in revenue and profit for first time in two years

In FY3/22 consolidated interim results, revenue increased 10.7% year on year (YoY) to ¥50,897mn, while operating profit rose 141.4% YoY to ¥6,714mn, both increasing for the first time in two years. The main factor behind the increase in revenue was that the Company did not close halls in the pachinko business as it had in April and May 2020 following the government's declaration of a state of emergency, resulting in an increase in the number of days of operation. However, the return of customers to halls was tepid, and the recovery was limited in 2021 due to the continuing COVID-19 pandemic. Meanwhile, the Company reduced business expenses by 3.4% YoY, as it worked to reduce personnel costs by making changes to hall operations, and there was a change* in accounting treatment. With this, operating profit increased significantly.

* Due to the fact that the average useful life of pachinko and pachislot machines exceeds two years, the Company changed from booking the cost as a lump sum when purchasing a machine to booking the machine as an asset and depreciating it over two years using the straight-line method. As a result, machine-related costs including depreciation declined ¥210mn YoY to ¥5,483mn.

### 2. FY3/22 business strategy

For FY3/22 results, the Company aims to continue to post an increase in revenue and positive operating profit. In Japan, despite the temporary decline in infections as progress is being made on COVID-19 vaccinations, the recovery in customers is still tepid, and it will likely take more time for customer levels to return to pre-pandemic levels. In terms of costs, depreciation expenses for pachinko and pachislot machines is expected to increase in 2H compared to 1H, so if operating rates stay at the same level, 2H profit will likely take a hit. As a result, the Company is promoting a product strategy that matches the profile of customers and will execute sales promotion initiatives with the aim of increasing operating rates. In addition, it plans to continue to promote cost management, centered on personnel costs, through reforms of hall operations.

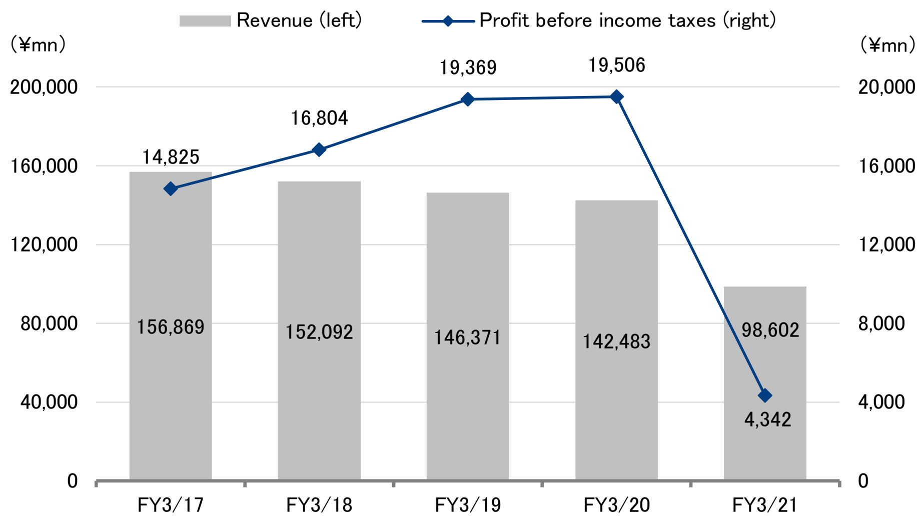
### 3. Pachinko business growth strategy

With the aim of achieving growth in the pachinko business, the Company will work on five different fronts: multiple-hall development, product development, data-driven approach, and cost management. Amid the prolonged COVID-19 pandemic, the number of pachinko halls has continued to decline, and the industry continues to face headwinds. However, looking at it another way, it is a good opportunity to increase market share. While the Company is the industry leader in terms of the number of halls, its market share is around 5%, and there is considerable room for growth. Although the Company will work on making increases to the profitability of existing halls its top priority for the time being, it is expected to resume hall openings and M&A once it reaches the stage at which profitability becomes stabilized. Additionally, in the near term, it will work to bolster hall profitability by reviewing operations, increasing the ratio of private-brand machines, and advancing a strategy of putting in place pachinko and pachislot machines using a data-driven process, along with other measures. At FISCO, we think that over the next couple of years the elimination and consolidation process in the pachinko hall industry will gain more steam, and the companies that survive will have a road towards growth open up to them through an increase in market share.

### Key Points

- In the FY3/22 interim period, revenue and profit increased due to the increase in the number of operating days and cost management
- In the pachinko business, the Company worked to manage costs by reforming hall operations and introducing private-brand machines, and is aiming for operating profit again for the full year of FY3/22
- As the industry overall faces headwinds caused by the COVID-19 pandemic, the Company will solidify its low-cost operations and aim for an increase in market share after the COVID-19 pandemic gets under control

Trends in operation results




Source: Prepared by FISCO from the Company's financial statements announcement

# Company profile

## Expanded business scope by implementing innovative measures premised on "chain store theory," first pachinko hall operator to list shares

### 1. History

The Company was founded as Sawa Shoji Co., Ltd. in 1967 by Yohei Sato, the father of Yoji Sato, a current director and senior corporate advisor. When the founder passed away suddenly in 1970, his eldest son, Yoji, who was then aged 24 and working at The Daiei, Inc., took over the business, and steadily expanded operations.

The Company pioneered in the pachinko hall industry by acting on new initiatives ahead of peers, including hiring new university graduates, opening suburban and low-cost halls, forming a labor union, and spreading low playing cost operations nationwide. Yoji Sato's leadership was an important factor in the Company's adoption of a progressive corporate culture. He joined Daiei due to interest in the chain store theory that was still a novel concept in Japan. Subsequently, following the death of his father, the founder, he took over management of the Company, and in the process, expanded business by consistently applying the chain store theory to pachinko hall operations. The chain store theory is the source of low-cost operations, the Company's largest strength.

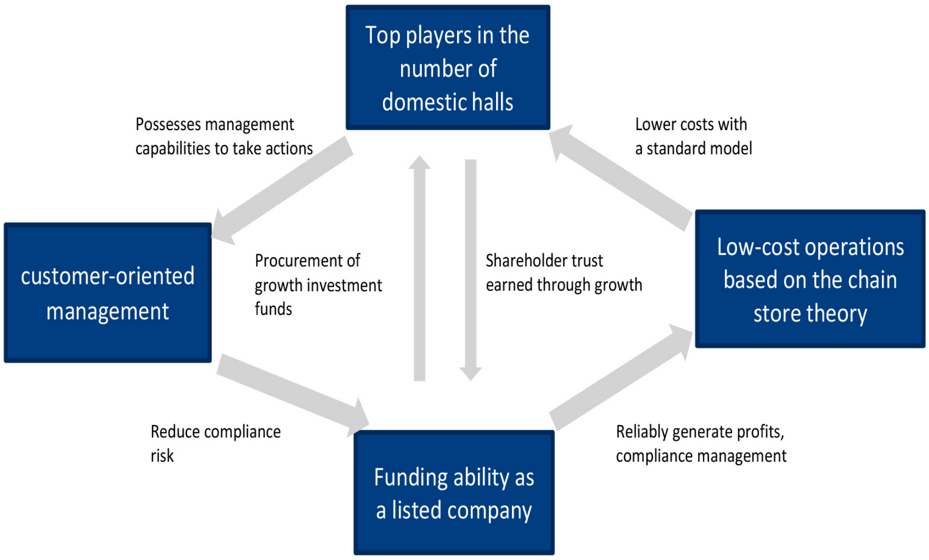
His logical approach rooted in the chain store theory took hold as the corporate culture and served as a fundamental force lifting the Company to the top position in the industry. It was also quick to embrace the most important concepts of modern management, such as a customer-first approach, information disclosure, and compliance, providing a foundation for its listing on the Hong Kong Stock Exchange in August 2012.

## Established a robust management foundation that leverages four strengths, differentiates itself from other companies

### 2. DYNAM JAPAN HOLDINGS Group's features and strengths

We focus on four points as the Company's attributes and strengths-1) top player in terms of the number of halls in Japan, 2) low-cost operations, 3) customer-oriented management, and 4) fund-raising capabilities. Importantly, these strengths are mutually interactive. We think it is difficult for other companies to realize the same combined strength seen at the Company.

Relationship among the four strengths of the Dynam Japan Holdings Group

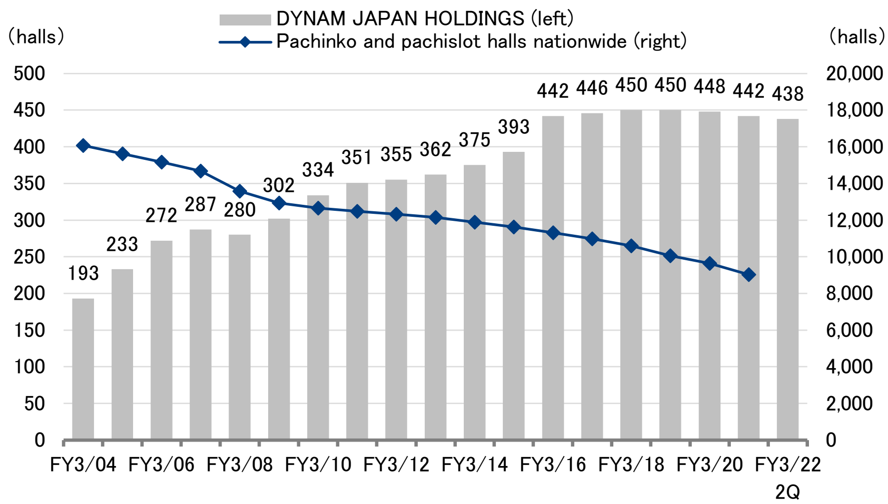



Source: Prepared by FISCO from interviews

### (1) Domestic leader with 438 group halls

The Company is the domestic leader with 438 group halls (as of the end of September 2021). While it is not possible to make precise comparisons due to differences in compilation timing, its domestic shares for the number of halls and machine installations are both at around 5%. Its market share exceeded 1% in 2003, and since then it has increased its number of halls, including through M&A, and maintained its market share amid the decrease in the overall number of halls in the industry. Since FY3/19, the number of halls has been declining slightly, partially due to the deterioration in the industry environment, but the Company's market share has been steadily growing.

Trend in number of group halls




Source: Prepared by FISCO from the Company's financial statements announcement and the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2020"

In promoting multi-hall operations, the Group uses a standardized format when opening stores and mainly focuses on large population centers in rural areas (commercial areas with populations of 30,000 to 50,000 people) where rents can be kept down. By increasing the number of halls and leveraging economies of scale, the Company is able to keep down the costs for purchasing pachinko and pachislot machines, prizes, and other items. The large number of halls means it buys more machines, and thus has stronger buying power with amusement equipment manufacturers. The Company also proactively develops and deploys private-brand machines (as of the end of September 2021, 14.8% of its installed pachinko machines were private-brand machines), and realizes economies of scale in this respect as well. Furthermore, it has established logistics centers that cover around 30 halls in 16 locations nationwide, and is curbing machine costs (costs related to purchasing amusement machines) and reducing logistics costs by having halls flexibly lend machine models to one another. In doing so, the Company is managing halls in an agile manner, including adjusting machine model lineups according to customer needs, and it has built a system enabling it to both increase the number of customers and reduce costs.

**(2) Chain store theory**

Low-cost operations based on the chain store theory are a vital source of the Company's competitiveness. Our understanding is that this aspect is tremendous support in enabling the Company to secure the feasibility and effectiveness of various measures, including the growth strategy.

Costs of machines and personnel constitute a large portion of the total cost of operating a pachinko hall. In addition to direct cost cutbacks, the Company is deploying hall designs and hall operating systems (such as ball counters at each machine) that facilitate operations with a small number of employees and standardizing new halls. The chain store theory plays an important role in a variety of ways and is enabling low-cost operations for the Group overall.

The Company is the industry leader in Japan, as mentioned earlier, with 438 halls. Aggressive hall network expansion supports this position, but the driving force of the chain store theory know-how has been an essential enabler. Hall network expansion has created a virtuous cycle of cost reductions through economies of scale that has put the Company in its strong position. We think the customer-oriented management explained below is an outcrop from the chain store theory as well.

The history section explained the background to the Company's utilization of the chain store theory in its management. In 2003, it established the Pachinko Chain Store Association (PCSA), an industry group (a general incorporated association) with peers who have a similar view. By promoting the activities of PCSA, the Company contributed to strengthening the management foundations of its industry peers, and this led to Yume Corporation Co., Ltd. joining the Group in November 2015. In October 2020, PCSA merged with the Japan Association of Pachinko Industry Executives (a general incorporated association), with the new, post-merger entity named the Mirai Pachinko Industry Federation (a general incorporated association).

**(3) Implementing management from a customer perspective**

The Company advocates a customer-first approach as one of its five business policies and has been practicing it. This stands out because we think few peers who promote a similar policy are actually seeing actions through.

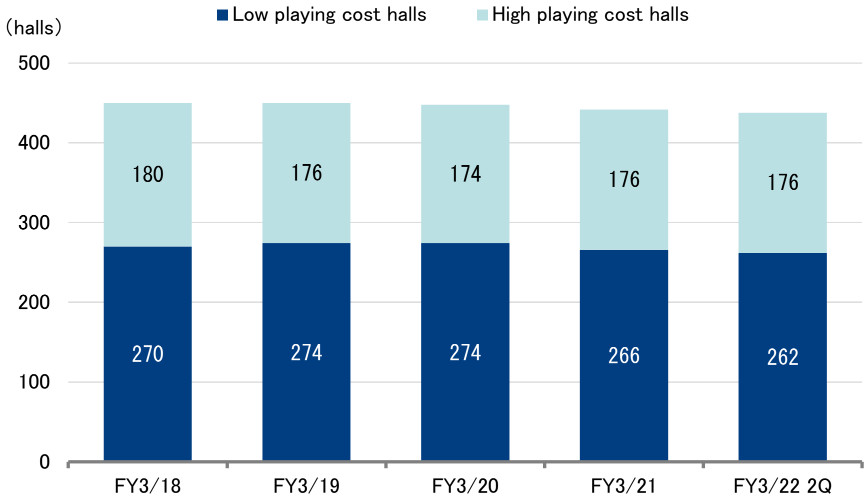
Among the Company's business policies, we have a favorable view of a) low playing cost operations and b) operations that do not rely on gambling appeal. These are also key words for understanding its business policy and growth strategy.

### a) Low playing cost operations

Pachinko is a game played with rented balls, and low playing cost operations refer to a format in which ball rental fees has been lowered to ¥1 or ¥2 per ball, which is cheaper than the standard price of ¥4. Customers can rent more balls for the same amount, extending their playing time in accordance with the additional balls. For the Company, whose goal is for everyone to be able to easily enjoy pachinko as part of the infrastructure of a region, it can be said that increasing low playing cost halls is a rational measure.

At the end of September 2021, the Company had 262 low playing cost halls, which is 59.8% of its total halls. The number of low playing cost halls declined versus the end of March 2021 due to the difficult management environment resulting from the COVID-19 pandemic, but the Company has made no changes to its plans to increase the ratio of low playing cost halls over the medium to long term. This is due to the fact that low playing cost halls are better able to draw in customers, especially elderly customers, than high playing cost halls. Continuing this strategy requires considerable company wherewithal, and the strategy for this lies in multiple-hall development and low-cost operations.

**Number of low playing cost halls and high playing costs halls**




Source: Prepared by FISCO based on t the Company's annual report and news releases and materials provided by the Company

### b) Operations that do not rely on gambling appeal

The Company does not position models with strong gambling appeal as a central strategy. Pachinko machines range from ones with high probability of major wins to ones with low probability. Machines with lower probability give a larger number of balls in a major win and are preferred by pachinko fans. Many pachinko halls hence attract customers by operating halls with a high ratio of machines with strong gambling features.

However, based on the strengthening of measures to address gambling addiction and related issues, the regulatory authorities have been revising the regulations in stages in order to suppress the gambling aspect, and the current situation is that a style of managing pachinko halls by attracting customers through "selling" gambling is coming to an end. The Company, meanwhile, has a lower ratio of gambling-type machines than the industry average, and conversely its share of machines with the lowest gambling features at 1/100 probability is 20 percentage points higher than the industry average. It cannot avoid the impact of stricter regulations on gambling appeal, but given the fact that it has been working on sales operations that do not rely on gambling appeal for some time now, we at FISCO feel that the negative impact on the Company will be comparatively minor.

**(4) Fund-raising capabilities that leverage strength as a listed company**

The Company became the first in the pachinko hall industry to list its shares with its IPO on the Hong Kong Stock Exchange in 2012. Only three companies, including the Company, out of the pachinko hall industry's roughly 2,500 companies are listed on stock markets as of the end of September 2021. The industry is projected to face realignment going forward. An important point for a buyer in this environment is obviously whether it has fund-raising capabilities. The Company capitalized on its strength as a listed company to acquire Yume Corporation in November 2015 through a stock swap for all of its shares. With respect to the demand for funds due not only to M&A but also investment in halls and new business development, the advantage of being a listed company is significant and will likely work in its favor in terms of procuring funds.

# FY3/22 interim results

## In the FY3/22 interim period, revenue and profit increased due to the increase in the number of operating days and cost management

**1. Summary of FY3/22 consolidated interim results**

In the FY3/22 consolidated interim results, revenue and profit rebounded for the first time in two years. Revenue increased 10.7% to ¥50,897mn, operating profit rose 141.4% to ¥6,714mn, profit before income taxes increased 278.2% to ¥5,586mn, and interim profit rose 395.8% to ¥3,416mn. Still, the number of customers did not fully recover, and results remain at a low level compared to before the COVID-19 pandemic (revenue was ¥74,052mn and operating profit was ¥14,042mn in the FY3/20 interim period).

**Summary of FY3/22 consolidated interim results**

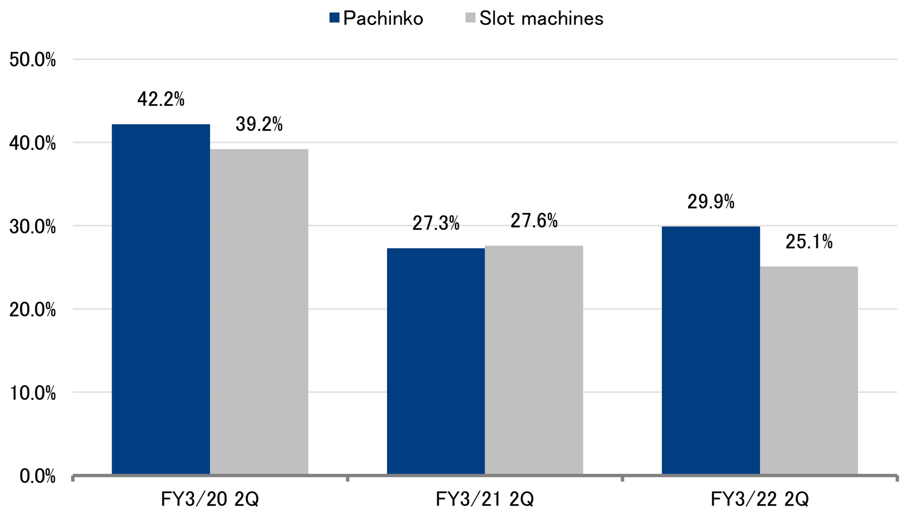
(¥mn)

| | FY3/21 Interim period | FY3/22 Interim period | FY3/22 YoY | FY3/22 Change | Remark |
|---|---|---|---|---|---|
| Revenue | 45,992 | 50,897 | 10.7% | 4,905 | |
| Revenue from pachinko business | 45,255 | 50,139 | 10.8% | 4,884 | High playing cost halls 24,682 (+2,925), low playing cost halls 25,457 (+1,959) |
| Revenue from aircraft leasing business | 737 | 758 | 2.8% | 21 | |
| Operating expenses | 46,840 | 45,255 | -3.4% | -1,585 | |
| Pachinko business expenses | 46,396 | 44,791 | -3.5% | -1,605 | Personnel costs -1,186 |
| Aircraft leasing business expenses | 444 | 464 | 4.5% | 20 | |
| SG&A expenses | 2,082 | 2,004 | -3.7% | -78 | |
| Other income | 6,142 | 5,025 | -18.2% | -1,117 | Employment adjustment subsidy from the government -1,701 |
| Other operating expenses | 431 | 1,949 | 352.2% | 1,518 | Hall impairment loss +1,243 |
| Operating profit | 2,781 | 6,714 | 141.4% | 3,933 | |
| Financial income | 154 | 156 | 1.3% | 2 | |
| Financial expenses | 1,458 | 1,284 | -11.9% | -174 | |
| Profit before income taxes | 1,477 | 5,586 | 278.2% | 4,109 | |
| Pachinko business | 4,227 | 8,024 | 89.8% | 3,797 | |
| Aircraft leasing business | 120 | 122 | 1.7% | 2 | |
| Company-wide expenses | -2,870 | -2,560 | - | 310 | |
| Interim profit | 689 | 3,416 | 395.8% | 2,727 | |

Source: Prepared by FISCO from the Company's financial statements announcement and results briefing materials

With respect to revenue, a factor behind the increase in revenue in the pachinko business was the increase in the number of operating days as the entire industry did not close halls as it had in April and May 2020 in response to the Japanese government's declaration of a state of emergency. However, in 2021, waves four and five struck in May and August, respectively, centering on major metropolitan areas. Due to concerns about infection, the return of customers was tepid and the recovery in revenue was limited. In fact, looking at DYNAM's hall data, the operating rate of pachinko machines was 29.9%, which was up slightly from 27.3% YoY, but only 70% of the level seen two years ago prior to the COVID-19 pandemic. In addition, for slot machines, due to the impact of deploying machines with less gambling appeal under the new regulations, and the fact that there were no hit models, the operating rate was even lower than in the previous year, and the declining trend in revenue is continuing.

Operating rates




Note: Data are for DYNAM halls. Operating rate = Actual number of customers/number of machines at peak time (around 3:00pm)
Source: Prepared by FISCO from materials provided by the Company

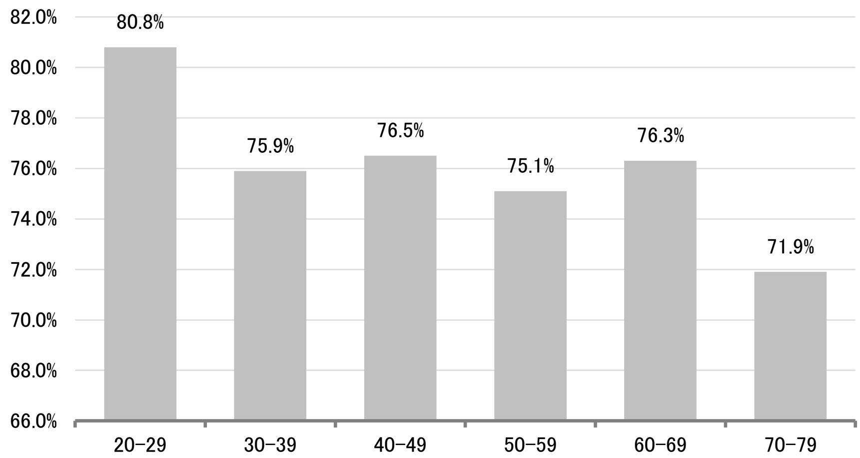
Meanwhile, business expenses declined 3.4% YoY to ¥45,255mn. In the pachinko business, the main factor was the ¥1,186mn decline in personnel costs.

In other revenue, vending machine fee income increased ¥168mn in conjunction with the recovery in the number of operating days for halls, but the employment adjustment subsidy from the government declined ¥1,701mn. The Company also booked hall-related impairment losses of ¥1,278mn as other expenses.

### (1) Pachinko business

In the pachinko business, revenue increased 10.8% YoY to ¥50,139mn, while segment profit rose 89.8% to ¥8,024mn. Of revenue, revenue from high playing cost halls increased 13.4% to ¥24,682mn, while revenue from low playing cost halls rose 8.3% to ¥25,457mn, as the recovery in low playing cost halls was comparatively tepid. The main factor for this is believed to have been the fact that elderly customers, who tend to visit low playing cost halls, were more hesitant to return to halls amid the ongoing pandemic. According to the Company's member data, the rate of return of customers by age group from before the pandemic (February 2019) to since the pandemic (September 2021) is 80.8% for members age 20-29 and approximately 75% for members age 30-69, but only 71.9% (the lowest) for members age 70-79. Another reason is that the number of halls declined. While the number of high playing cost halls was unchanged from March 31, 2021, at 176 halls, the number of low playing cost halls declined by 4 halls to 262 halls.

Customer return rate by age group since the start of the COVID-19 pandemic




Note: Calculated based on DYNAM member data from net number of hall visitors in February 2019 and September 2021
Source: Prepared by FISCO from materials provided by the Company

In FY3/22, in conjunction with the revised Act on Control and Improvement of Amusement Business, etc., the Company must, by January 31, 2022, replace its pachinko machines and pachislot machines with machines complying with the new regulations that limit gambling appeal, so more machines are being replaced than in a normal year. At the end of March 2021, approximately 51% of installed machines, or 105,000 machines, were under the former regulations. All of these machines must be either replaced with machines complying with the new regulations, or simply removed, by the end of January 2022. As of the end of September 2021, 76% of installed machines complied with the new regulations, and this percentage increased to 88% of machines held in inventory, so the Company is making good progress on replacing machines. Purchasing costs increased significantly YoY, but as mentioned above, costs have been kept down by changing to cost accounting using a two-year depreciation method.

Also, by executing reforms of hall operations, the Company was able to reduce hall personnel costs by ¥1,186mn, and depreciation expenses on right-of-use assets declined ¥425mn. Although advertising expenses increased ¥611mn as a result of resuming initiatives to attract customers, overall business expenses declined ¥1,605mn. Moreover, while there was a decline in the employment adjustment subsidy, etc. from the government and the Company booked an impairment loss, segment profit increased ¥3,797mn due to the increase in revenue and the decline in business expenses.

Looking at the results for DYNAM Co., Ltd., which is the Group's core company, revenue increased 11.2% YoY to ¥47,222mn, while operating profit was ¥2,436mn (compared to an operating loss of ¥2,401mn in the same period of the previous fiscal year). The employment adjustment subsidy, etc. from the government booked in non-operating profit declined, but ordinary profit increased 431.9% YoY to ¥4,542mn.

DYNAM's interim results (using Japanese accounting standards)

(¥mn)

| | FY3/21 Interim period | FY3/22 | | | Summary |
|---|---|---|---|---|---|
| | | Interim period | YoY | Change | |
| Revenue | 42,457 | 47,222 | 11.2% | 4,766 | |
| Total expenses | 44,858 | 44,786 | -0.2% | -72 | |
| Machine costs | 5,073 | 4,974 | -2.0% | -99 | Switched from lump-sum cost accounting to two-year depreciation for pachinko and pachislot machines above ¥100,000 |
| Personnel costs | 19,365 | 18,920 | -2.3% | -445 | Decline in personnel costs for part-time employees |
| Other costs | 20,420 | 20,892 | 2.3% | 472 | |
| Operating profit | -2,401 | 2,436 | -201.5% | 4,837 | |
| Ordinary profit | 854 | 4,542 | 431.9% | 3,688 | |
| Interim profit | 371 | 2,878 | 675.7% | 2,507 | |
| Main KPIs (key performance indicators) | | | | | |
| No. of halls | 404 | 398 | | -6 | New hall openings: None<br>Closed halls: Hitachi Hall, Saga Kanzaki Hall, Tottori Yasunaga Hall, Ehime Imabari Hall, Tochigi Oyamakizawa Hall, Miyakonojo Hall |
| Pachinko machine operating rate | 27.3% | 29.9% | | 2.6pt | Gap with competitors +3.2pt |
| Slot machine operating rate | 27.6% | 25.1% | | -2.4pt | Gap with competitors -1.0pt |
| No. of machines | 189,339 | 186,851 | -1.3% | -2,488 | Installed machine share 4.7% |
| Number of private-brand machines | 14,969 | 19,436 | 29.8% | 4,467 | Private-brand machine installation rate* 14.8% (difference from previous period: +3.6pt) |

* Private-brand machine installation rate is the percentage of total installed pachinko machines
Source: Prepared by FISCO from the Company's results briefing materials and materials provided by the Company

As of September 30, 2021, the Group had 398 halls, a decline of 6 halls from September 30, 2020, and the number of installed machines also declined slightly by 1.3% to 186,851 machines. However, the number of private-brand machines increased 29.8% to 19,436 machines, as the Company raised the ratio of private-brand machines purchased as a way to manage costs. The machine operating rate for pachinko machines rose 2.6pp YoY, but the operating rate for pachislot machines declined 2.4pp.

### (2) Aircraft leasing business

In the aircraft leasing business, revenue increased 2.8% YoY to ¥758mn, while segment profit rose 1.7% to ¥122mn. The Company has limited its scope of business to narrow-body aircraft, which are highly liquid and for which demand is expected to be stable. It is continuing the leases of three aircraft purchased in FY3/20, and revenue increased due to the depreciation of the yen. The fleet value for the three aircraft is ¥15,862mn, and the annualized gross rate of return was 8.8%.

Results for aircraft lease contracts (as of September 2021)

| Leasing party | Contract period | Model | Assets (Net value) | Average age | Average remaining lease period | Annualized gross rate of return |
|---|---|---|---|---|---|---|
| Vueling Airlines (Spain) | July 2019 | Airbus A320 | ¥15,862mn | 2.6 years | 4.1 years | 8.8% |
| IndiGo (India) | October 2019 | Airbus A320N | | | | |
| IndiGo (India) | February 2020 | Airbus A321N | | | | |

Source: Prepared by FISCO from the Company's results briefing materials and materials provided by the Company

# Capital ratio increased despite the decline in cash on hand due to the increase in the amount spent on purchasing pachinko and pachislot machines and the repayment of interest-bearing debt

### 2. Financial condition

At the end of the FY3/22 interim period, total assets decreased ¥14,202mn versus the end of the previous fiscal period to ¥286,871mn. The main factor for the change was the ¥23,412mn decline in cash and deposits mainly due to the purchase of non-financial assets centered on pachinko and pachislot machines, payment of unpaid income tax payable, and repayment of interest-bearing debt. Meanwhile, property, plant and equipment increased ¥19,258mn to ¥115,673mn, mainly due to booking pachinko and pachislot machines as non-financial assets, while right-of-use assets declined ¥1,809mn to ¥75,728mn due to the decrease in the number of halls.

Total liabilities decreased ¥13,553mn compared to the end of the previous fiscal period to ¥155,548mn. This was mainly due to the ¥1,625mn decline in interest-bearing debt to ¥32,342mn and the ¥5,282mn decline in accounts payable and accrued expenses, mainly due to the payment of income tax payable. Additionally, lease liabilities declined ¥1,555mn.

Total equity was down ¥649mn from the end of the previous fiscal period to ¥131,323mn. While the Company posted net profit attributable to owners of the Company of ¥3,416mn in the interim period, dividend payments were ¥1,505mn, and ¥2,241mn was used on the acquisition and retirement of treasury shares. It acquired and retired 21,195,000 shares (approximately 2.8% of outstanding shares).

Mainly due to the decrease in liabilities, the capital ratio increased from 43.8% at the end of FY3/21 to 45.8%. However, net cash, which is the difference between cash and deposits and interest-bearing debt, was ¥18,907mn, a ¥21,787mn decline from the end of the previous period. This was mainly due to the ¥28,109mn spent to purchase property, plant and equipment, centered on purchasing costs of pachinko and pachislot machines, which increased significantly. However, the amount spent on purchasing machines peaked during the interim period, and is expected to decline in 2H and beyond. While there is a possibility that cash on hand will decline further towards the end of FY3/22, the Company continues to plan to operate its business while maintaining financial soundness.

**Consolidated financial condition**

(¥mn)

| | End-FY3/20 | End-FY3/21 | FY3/22 interim period-end | Change | Change items |
|---|---|---|---|---|---|
| Total assets | 277,239 | 301,073 | 286,871 | -14,202 | Cash and cash equivalents (-23,412), booked as property, plant and equipment for pachinko and pachislot machines (+21,649) |
| (Cash and cash equivalents) | 41,810 | 74,661 | 51,249 | -23,412 | |
| Total liabilities | 142,507 | 169,101 | 155,548 | -13,553 | Interest-bearing debt (-1,625), lease liabilities (-1,555), accounts payable and accrued expenses (-5,282) |
| (Interest-bearing debt from pachinko business) | 2,007 | 23,629 | 22,447 | -1,182 | |
| (Interest-bearing debt from aircraft leasing business) | 11,221 | 10,338 | 9,895 | -443 | |
| Total equity | 134,732 | 131,972 | 131,323 | -649 | Interim profit (+3,416), dividend payments (-1,505), acquisition and retirement of treasury shares (-2,241), other comprehensive income (-319) |
| (Capital ratio) | 48.6% | 43.8% | 45.8% | 2.0pt | |
| (Net cash) | 28,582 | 40,694 | 18,907 | -21,787 | |

Source: Prepared by FISCO from the Company's financial statements announcement and results briefing materials and materials provided by the Company

Cash flow statement

(¥mn)

| | FY3/21 Interim period-end | FY3/22 Interim period-end |
|---|---|---|
| Cash flow from operating activities | 13,363 | 10,519 |
| Cash flow from investing activities | -1,207 | -23,115 |
| Free cash flows | 12,156 | -12,596 |
| Cash flow from financing activities | 14,068 | -10,865 |
| Cash and cash equivalents | 67,840 | 51,249 |

Source: Prepared by FISCO from an interim report

# FY3/22 business strategy

## In the pachinko business, the Company worked to manage costs by reforming hall operations and introducing private-brand machines, and is aiming for operating profit for FY3/22

### 1. Pachinko business

#### (1) Business strategy

The Company's outlook for FY3/22 2H continues to be that the revenue and profit environment will remain challenging as the return of customers has been more tepid than initially expected (recovery to the level seen prior to the pandemic was expected by March 2022), and depreciation costs for pachinko and pachislot machines are expected to increase in 2H compared to the interim period. Under these circumstances, how the Company increases the operating rate and further improves the efficiency of hall operations will be the key points that influence the profit trend.

If the operating rate in FY3/22 2H remains at the same level as in the interim period, full-year revenue may only increase in the single digits YoY, so it is necessary for the Company to raise the operating rate to increase revenue. Currently, more than 75% of the Japanese population has received two doses of the COVID-19 vaccine, and concerns about infection have eased slightly, especially among young people, but the number of infections is increasing again in Europe, and preparations for administering a third vaccine shot in Japan are underway, so the mood remains cautious.

Under these circumstances, the Company will promote product strategies and sales promotion activities tailored to the customer profile, continue to implement thorough infection control measures in halls, and create an environment where players can play with peace of mind, thereby promoting the return of elderly people to halls and recovering the number of customers while at the same time increasing the operating rate.

Sales initiatives amid the COVID-19 pandemic

| | Age | Product strategy | Sales promotion activities | Period of measures |
|---|---|---|---|---|
| Actions based on customer profile | Young customers | Increase the ratio of machines with 1/200, 1/300 probabilities | Marketing advertisements on SNS | Short term |
| | Elderly customers | Reduce the number of Umimonogatari Series machines to an appropriate number | TV commercials/DM, etc. during the period for attracting customers | Medium to long term |
| COVID-19 countermeasures | The Company is encouraging elderly customers, who are curbing their activities, to return to halls by continuing countermeasures including temperature checks, disinfecting surfaces, mask-wearing, and social distancing. These measures also prevent the recurrence of a COVID-19 outbreak. | | | |

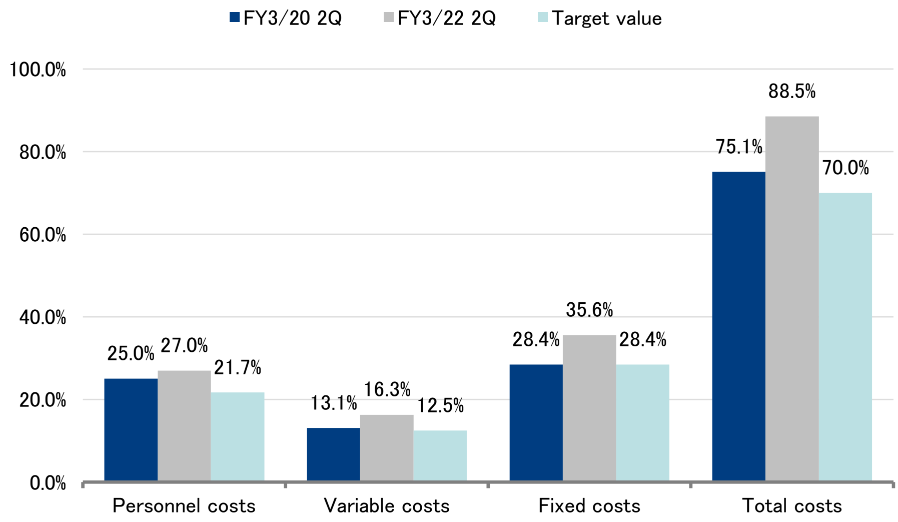
Source: Prepared by FISCO from the Company's results briefing materials

Regarding the replacement of pachinko machines under the former regulations with machines complying with the new regulations, the Company expects the transition to be completed by the end of January 2022 as scheduled. On the other hand, with respect to pachislot machines, there are currently few sales of models that customers like, so they will merely be removed rather than replaced. The Company is considering the option of deploying new models for which high operating rates can be expected as they are released.

### (2) Cost improvement measures

As initiatives to bolster profitability, the Company has been reforming hall operations on a trial basis and proactively introducing private-brand machines since before the COVID-19 pandemic. Regarding reforms to hall operations, it has been implementing initiatives on a full-fledged basis since FY3/21, and the reduction of total hours worked by hall staff has led to a decline in personnel costs. In addition to reviewing the frequency and content of tasks, the Company regularly holds operational improvement contests to raise the level of enthusiasm for work improvements in halls. As a result of these types of initiatives, the total hours worked by hall staff per month is now approximately 75% of what it was two years ago in FY3/19. Furthermore, as a measure to reduce fixed costs, the Company is having staff clean halls during operating hours to reduce outsourcing costs, along with other measures.

Ratio of hall expenses to revenue




Source: Prepared by FISCO from the Company's financial statements announcement and materials provided by the Company

As the second cost improvement measure, the Company is trying to curb machine purchasing costs, which is one of the two major costs involved in hall operations. It has built cooperative relationships with manufacturers, and has deployed 79 types of private-brand machines as of the end of FY3/21. Over the past three years, the price of private-brand machines has become approximately 15% lower than the price of national brand machines. The private-brand machines are centered on Ama Deji (jackpot probability of less than 1/100) types and offer big advantages, including enabling provision of machines that match customer needs and flexibility in specification design based on in-house development.

For DYNAM Co., Ltd., the ratio of private-brand machines to the total number of installed pachinko machines increased from 9.5% in FY3/20 to 12.7% in FY3/21 and 14.8% in the FY3/22 interim period, as there has been an upward trend each year. Amid the slight decline in the overall number of installed machines compared to the end of FY3/21, the number of private-brand machines increased 29.8% to 19,436 machines, as the upward trend continues. Going forward, in addition to increasing the ratio of private-brand machines, the Company aims to lower the price of private-brand machines to half the current price in the future.

## In the aircraft leasing business, the Company newly concluded purchase agreements for three aircraft

### 2. Aircraft leasing business

In the aircraft industry, conditions remain challenging amid the COVID-19 pandemic, and it is expected to take until 2023 or 2024 for demand for long-distance international flights to recover, while demand for short-distance domestic flights is gradually recovering. In the industry, it is expected that passenger transport volume will grow by an average of 4.0% per year over the next 20 years and global aircraft demand will be continuing to grow with demand for 43,610 new aircraft, mainly narrow-body aircraft used for short-distance transport, by 2040 (there were 25,900 aircraft in operation as of 2019). Therefore, there is no change to the outlook that the aircraft leasing business will stably grow over the medium to long term.

In October 2021, the Company announced that it its subsidiary engaging in this business (Dynam Aviation Ireland Limited) had entered into an agreement with Wizz Air, a Hungarian LCC, to purchase three Airbus A321Neo aircraft through a sale and leaseback agreement. When the aircraft purchase agreement is completed, each of the aircraft will be leased to Wizz Air or an affiliate of Wizz Air. Two of the aircraft are scheduled to be delivered in April–June 2022, while the third is scheduled to be delivered in July–September 2022.

The Company expects FY3/22 results to be on par with FY3/21, but forecasts an increase in both revenue and profit from FY3/23 as lease income from these three aircraft are booked.

## The Company is preparing to restart sales activities for video slot machines after the pandemic gets under control

### 3. Progress in the video slot machine business for casinos

The Company has been working on planning and development with the aim of deploying video slot machines in the Macau casino market as a new business. These video slot machines are more targeted to the mass-market than other types of machines, and the development concept is to make straightforward games that incorporate elements of pachinko.

The Company jointly developed the plan for the game software in Japan with a developer, and then outsourced the manufacturing and sales of the games for casinos to WEIKE GAMING TECHNOLOGY (S) PTE. LTD. (WEIKE), a Singapore-based company that holds a license for manufacturing and selling casino machines in Macau. As of November 2021, the Company has obtained approval for six models from the Macau casino regulatory authorities and five models in Singapore. In addition, since November 2019, one of each of the three models of machines that incorporate the developed game (total of three machines) were deployed on a test basis in Legend Palace Casino, and from January 2020, a total of ten machines representing three machine models were deployed on a test basis in Casino Ponte16.

Since the start of 2021, Macau's casino GGR (gross gaming revenue) recovered to approximately 40% in May compared to the same month in 2019 prior to the COVID-19 pandemic, but since then the recovery has stalled due to COVID-19 infections in mainland China and other factors. The Company recognizes that it will still take time for the casino market to recover, and is preparing to restart sales activities, including trials, as soon as the market normalizes. In addition, information is being gathered in order to consider the possibility of widening its sales targets to other countries in Asia.

The time needed from trial to full-scale introduction and the scale (number of units) remain unclear, but if chosen by many customers, these machines should lead to a decent contribution to profits. In any case, the most important thing is that the Company's new products be attractive machines for customers and casino operators, and we at FISCO want to monitor the operation and sales status of the machines that will be introduced on a trial basis after the market returns to normal.

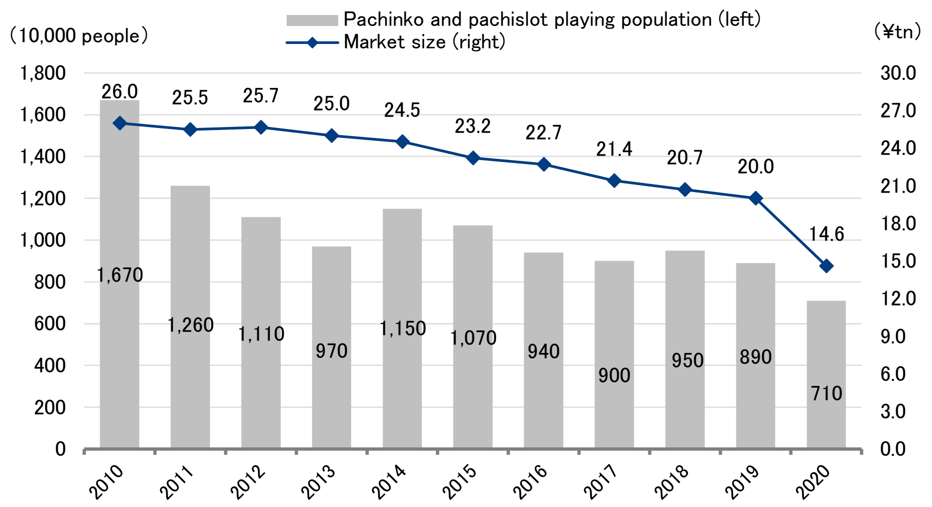
# Future growth strategy

## As the industry overall faces headwinds caused by the COVID-19 pandemic, the Company will solidify its low-cost operations and aim for an increase in market share after the COVID-19 pandemic gets under control

### 1. Market trends

The pachinko market continues to experience a long-term contraction trend. According to the "White Paper on Leisure 2021" issued by the Japan Productivity Center, Japan's pachinko and pachislot playing population in 2020 was 7.1 million, a 20% YoY decline, and the pachinko hall market size (total ball rental fee revenue) decreased 27% YoY to ¥14.6tn, as the pace of contraction accelerates even more.

Trends in the pachinko and pachislot playing population and pachinko hall market size

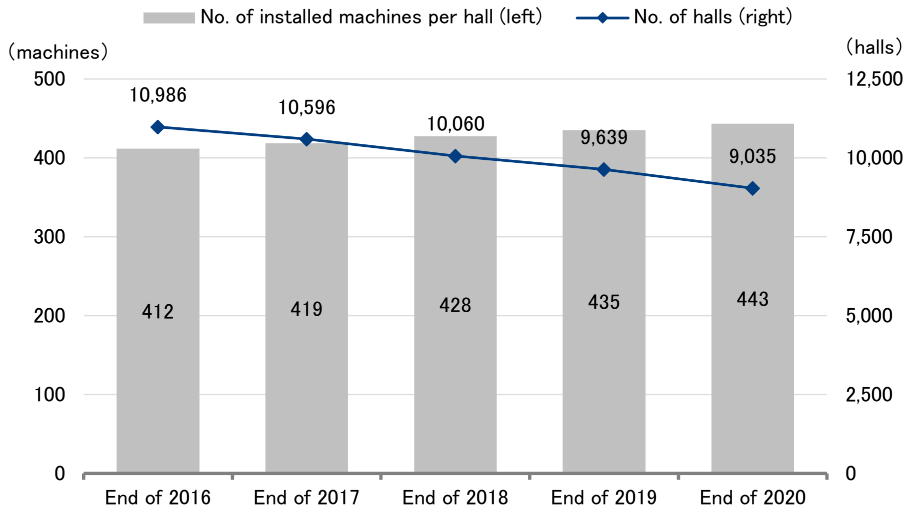



Source: Prepared by FISCO from the Japan Productivity Center's "White Paper on Leisure"

Reflecting these conditions, the number of pachinko and pachislot halls continues to decrease, and at the end of 2020, the number of halls was down 6.3% versus the end of the previous year to 9,035 halls (according to the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2020"). Moreover, in terms of the number of machines installed at the end of 2020, pachinko machines decreased 4.9% compared to the end of the previous year to 2,432,000 machines, and pachislot machines declined 4.0% to 1,572,000 machines, so both continue to trend downward. The elimination of small and medium-sized halls appears to be gaining steam even in 2021 as operating rates remain sluggish amid the COVID-19 pandemic and the investment burden related to the transition from machine models under the former regulations to those complying with the new regulations increase. In fact, the number of pachinko and pachislot machines per hall has been increasing in the last few years, and stood at 443 (+8 YoY) machines at the end of 2020. Incidentally, for the Group, the average number of pachinko and pachislot machines installed per hall as of September 30, 2021 was 472 machines.

Ball rental fee revenue per hall in FY3/20 was slightly more than ¥1.6bn, which was lower than the industry average of ¥2.07bn. The reason why its ball rental fee revenue was low despite the fact that the number of machines installed is above the industry average is because the percentage of low playing cost pachinko machines for the Company is approximately 70%, which is much higher than the industry average of just under 50%. As previously stated, it has positioned pachinko as a form of daily entertainment that anyone can enjoy, and has worked on implementing low-cost operations that allow it to secure profitability even with low playing cost operations, and this has allowed it to expand business. Profitability at low playing cost halls is struggling due to headwinds amid the COVID-19 pandemic, and it is expected that the low-cost operation know-how that the Company has cultivated up until this point will help secure earnings amid the adverse environment due to the cost management as previously discussed.

Number of halls and installed machines per hall




Source: Prepared by FISCO from materials provided by the Company and the National Police Agency's "Current Situation with Amusement and Entertainment Business and Situation with Policing Amusement and Entertainment-related Crime, etc. in 2020"

### 2. Growth strategy

As its growth strategy in the pachinko business, the Company will work on five themes: multiple-hall development, low playing cost operations, product development, data-driven approach, and cost management.

#### (1) Multi-hall operations

The effects of the COVID-19 pandemic have been prolonged, and the elimination of pachinko halls is accelerating. Amid this environment, the Company will continue to work on securing earnings from existing halls as a top priority in the near term, and is expected to advance hall operations by purchasing unoccupied properties and through M&A and other measures once stable earnings can be expected. Targeted properties must be medium-sized halls able to accommodate 400-500 pachinko and pachislot machines, and there must be no other Group halls nearby to avoid encroaching on another hall's customer base.

#### (2) Low playing cost operations

In general, the Company's new halls will have low playing costs. It has stated a vision of making pachinko and pachislot a form of daily entertainment that everyone can enjoy freely as a part of the community infrastructure, and will increase the number of low playing cost halls in order to achieve this vision. An advantage of focusing on low playing cost halls is that the Company can open halls in small commercial areas thanks to its wide-ranging customer base.

#### (3) Product development

The Company will strengthen its product development of private-brand machines. Developing and introducing products matching customer needs will help with cost management, and will be positioned as an important strategy in terms of differentiating its halls from those of competitors.

### (4) Data-driven approach

In its hall operations, the Company will advance efforts taking advantage of big data. Specifically, it will analyze customer needs based on playing data and customer data, and reflect the findings in pachinko and pachislot machine lineups to raise the operating rate.

### (5) Cost management

As discussed above, the Company will improve hall profitability by applying its hall operation revisions to all of its halls.

At FISCO, we believe that the consolidation in the pachinko hall industry by large capital will proceed, spurred by the COVID-19 pandemic. As a part of this, we forecast that this will be a good opportunity to rekindle growth based on market share expansion for the Company, which has a wide range of customers as a result of its low playing cost business and due to the fact that it has firmly established low-cost operations. Although the Group currently is the leader in the industry in terms of its number of halls, its market share is approximately 5%, and we feel there is ample room for growth through an expansion of its market share.

**Simplified income statement and key indicators**

(¥mn)

| | FY3/18 | FY3/19 | FY3/20 | FY3/21 | FY3/22 Interim period |
|---|---|---|---|---|---|
| Revenue | 152,092 | 146,371 | 142,483 | 98,602 | 50,897 |
| YoY | -3.0% | -3.8% | -2.7% | -30.8% | 10.7% |
| Operating expenses | 136,727 | 128,024 | 122,311 | 97,564 | 45,255 |
| YoY | -3.8% | -6.4% | -4.5% | -20.2% | -3.4% |
| SG&A expenses | 5,049 | 5,023 | 5,020 | 4,340 | 2,004 |
| YoY | -10.2% | -0.5% | -0.1% | -13.5% | -3.7% |
| Other income | 9,458 | 8,971 | 8,446 | 11,561 | 5,025 |
| Other operating expenses | 2,425 | 2,953 | 2,084 | 1,531 | 1,949 |
| Operating profit | 17,349 | 19,342 | 21,514 | 6,728 | 6,714 |
| YoY | 9.1% | 11.5% | 11.2% | -68.7% | 141.4% |
| Financial income | 236 | 471 | 461 | 286 | 156 |
| Financial expenses | 781 | 444 | 2,469 | 2,672 | 1,284 |
| Profit before income taxes (interim) | 16,804 | 19,369 | 19,506 | 4,342 | 5,586 |
| YoY | 13.3% | 15.3% | 0.7% | -77.7% | 278.2% |
| Income taxes | 5,879 | 6,778 | 6,759 | 1,991 | 2,170 |
| Net profit for the year (interim) | 10,925 | 12,591 | 12,747 | 2,351 | 3,416 |
| YoY | 17.4% | 15.2% | 1.2% | -81.6% | 395.8% |
| EBITDA | 29,524 | 31,136 | 33,151 | 16,781 | 11,187 |
| YoY | 3.7% | 5.5% | 6.5% | -49.4% | 42.4% |
| EPS (¥) | 14.2 | 16.4 | 16.6 | 3.1 | 4.59 |
| Dividend per share (¥) | 12.00 | 12.00 | 9.00 | 5.00 | 2.40 |

Source: Prepared by FISCO from the Company's financial statements announcement and results briefing materials and materials provided by the Company

Statement of consolidated financial position

(¥mn)

| | FY3/18 | FY3/19 | FY3/20 | FY3/21 | FY3/21 interim |
|---|---|---|---|---|---|
| Current assets | 53,145 | 59,875 | 55,798 | 91,790 | 62,120 |
| Cash and cash equivalents | 40,533 | 47,537 | 41,810 | 74,661 | 51,249 |
| Trade receivables | 469 | 614 | 554 | 361 | 335 |
| Other | 12,143 | 11,724 | 13,434 | 16,768 | 10,536 |
| Non-current assets | 131,826 | 125,457 | 221,441 | 209,283 | 224,751 |
| Property, plant and equipment | 98,794 | 95,445 | 105,206 | 96,415 | 115,673 |
| Licensing assets | - | - | 79,048 | 77,537 | 75,728 |
| Intangible assets | 3,545 | 3,112 | 3,623 | 3,348 | 3,191 |
| Investments, other | 29,487 | 26,900 | 33,564 | 31,983 | 30,159 |
| Total assets | 184,971 | 185,332 | 277,239 | 301,073 | 286,871 |
| Current liabilities | 39,643 | 36,452 | 44,028 | 59,812 | 50,813 |
| Accounts payable | 19,220 | 19,297 | 14,801 | 19,997 | 14,715 |
| Short-term borrowings, etc. | 7,351 | 2,124 | 3,008 | 11,380 | 13,245 |
| Lease liabilities | 256 | 227 | 12,185 | 12,040 | 11,567 |
| Other | 12,816 | 14,804 | 14,034 | 16,395 | 11,286 |
| Non-current liabilities | 7,813 | 7,080 | 98,479 | 109,289 | 104,735 |
| Long-term borrowings | 1,221 | 502 | 10,220 | 22,587 | 19,097 |
| Lease liabilities | 326 | 353 | 81,611 | 79,899 | 78,817 |
| Other | 6,266 | 6,225 | 6,648 | 6,803 | 6,821 |
| Total liabilities | 47,456 | 43,532 | 142,507 | 169,101 | 155,548 |
| Total equity | 137,515 | 141,800 | 134,732 | 131,972 | 131,323 |
| Total liabilities and equity | 184,971 | 185,332 | 277,239 | 301,073 | 286,871 |

Source: Prepared by FISCO from the Company's financial statements announcement and results briefing materials and materials provided by the Company

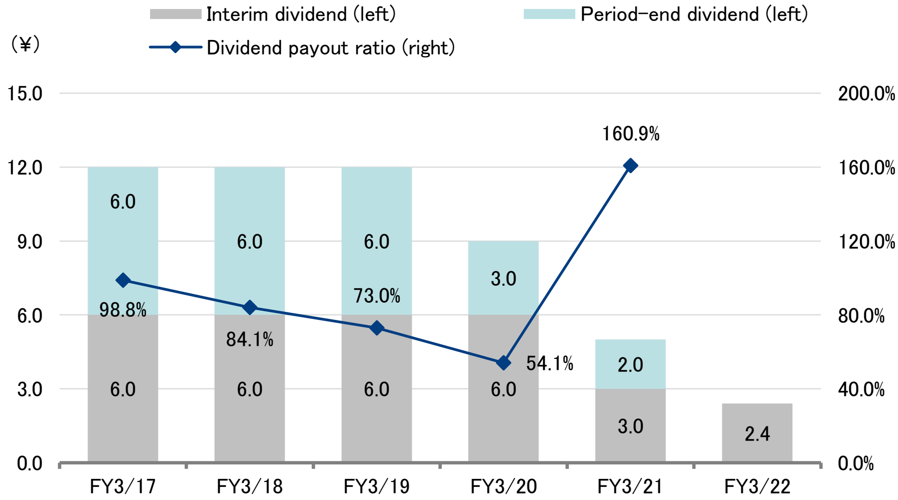
# Returns to shareholders

## Plans to pay a FY3/22 interim dividend of ¥2.4 per share

The Company is highly conscious of the significance of returns to shareholders because it recognizes the importance of raising shareholder value in order to achieve sustainable growth. Based on this view, its policy is to pay stable dividends.

In light of the current situation with earnings, the Company decided on a FY3/22 interim dividend of ¥2.4 per share. Furthermore, in the FY3/22 interim period, it carried out ¥2,241mn in stock buybacks (21,195,400 shares; approximately 2.8% of its outstanding shares).

Trends in dividend per share and the dividend payout ratio




Source: Prepared by FISCO from the Company's results briefing materials and news releases and materials provided by the Company

# ESG initiatives

### 1. Through ESG activities, the Company aims to grow sustainably and to maximize corporate value

With respect to the environment (E), social (S), and governance (G), the Company is earnestly continuing initiatives to increase value for all of its stakeholders, including investors.

Based on its Group Philosophy of "A centurial commitment to building trust and encouraging dreams," the Group is advancing ESG initiatives with the ideal of achieving perpetual growth, and it discloses information in accordance with the latest international guidelines and the listing rules of the Hong Kong Stock Exchange for each category (Environment, Social, Governance). Furthermore, details about the Company's initiatives can be found on its website and in ESG Report 2021. Amid the attention being focused on ESG investing, this is expected to fulfill an important role as a tool for dialogue with investors.

### 2. Environmental initiatives

Based on its recognition that global environmental problems are shared by all humans, the Company works to protect the environment through its businesses, and aims to reduce its environmental impact.

Economic activities are one of the causes of global environmental problems such as climate change, energy consumption, and pollution, and international targets have been set for global warming. The Company conducts environmental impact assessments in order to continue stable social activities going forward, and conducts environmental management focusing on areas such as appropriately managing energy usage, realizing a recycling society, and considering the local environment in which people live.

### 3. Social initiatives

The Group engages in initiatives aimed at "enhancing social value" through efforts targeting all stakeholders, including customers, communities, business partners, employees, and shareholders and investors.

The Company is carrying out a diverse range of initiatives aimed at "enhancing social value." Such initiatives include providing services from the perspective of customers in order to make "pachinko a form of daily entertainment," engaging in activities to promote pachinko as "local infrastructure," developing private-brand machines with pachinko and pachislot machine manufacturers, developing human resources (including active participation by women), and holding more briefings for investors.

### 4. Governance initiatives

The latest information about the Group's corporate governance is noted in detail in Annual Report 2021. This information can also be found on the Company's website.

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